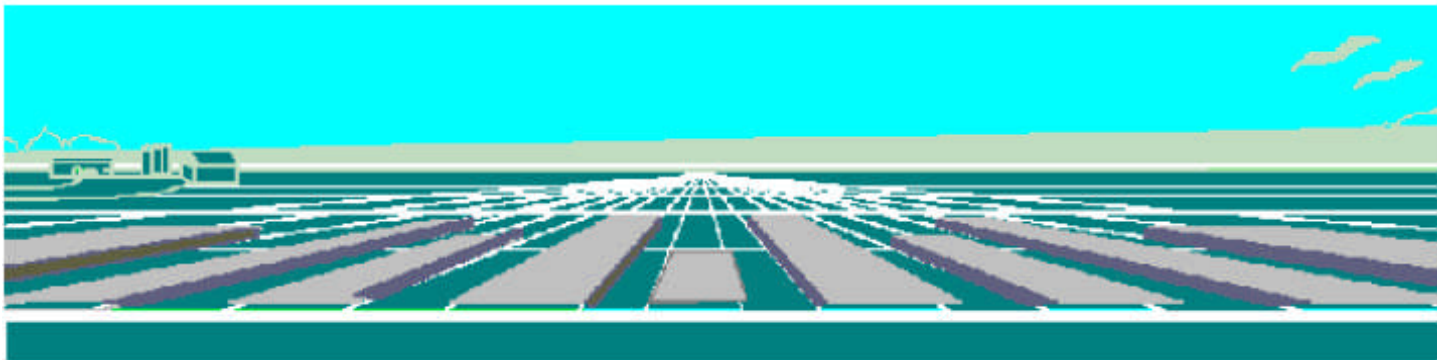


Iowa Farm Outlook



January 1, 2007

Ames, Iowa

Econ. Info. 1949

2007-Crop Corn Futures Move Above Late November High

Several developments in late December were the focus of grain trade activity in futures markets and helped to push December 2007 corn futures above earlier highs. Through December 29, this contract had closed above November 27, 2006 highs for five consecutive days. That plus continued strong export inspections and sales are indications that prices may work higher into mid-January. Positive market talk that helped support price strength included indications of accelerated ethanol plant construction activity and discussion of China's possible shift to a net corn importer next season. Some trade analysts think U.S. corn processing capacity for ethanol may reach 3.3 to 3.6 billion bushels during the next marketing year. That would be a very sharp increase from this season's projected 2.15 billion bushels, and would require more corn acres to be planted than most analysts have been projecting so far. ***USDA analysts project this season's exports to be up 2.5% from the 2005-06 marketing year total. Cumulative 2006-crop corn export sales so far this marketing year are up more than 39% from a year earlier and continue to suggest that actual marketing year exports may substantially exceed USDA projections. To reach the USDA projections, sales will have to slow dramatically in the months ahead.*** Export inspections (shipments) from September 1, 2006 through December 21 were 19.5% above a year earlier. To meet official projections, shipments from now through August 31 will need to be 4.3% less than a year earlier. ***With a marketing year corn export gain of 15 percent, total corn use this season would be 270 million bushels larger than USDA projects—unless livestock feeding or ethanol processing uses less corn than projected. Current market indicators suggest cuts in those areas are not yet occurring. Larger use would reduce carryover stocks to about 665 million bushels next August 31. That would be a very tight 2.8 weeks supply. U.S. corn carryover stocks in 1996 were about a 2.6 weeks supply at the end of August.*** In 1996, Iowa cash corn prices exceeded \$5 per bushel for more than five months. Higher corn prices may be needed in the months ahead, both to discourage corn feeding and exports and to encourage a sharper increase in corn plantings than previously anticipated in 2007 and later years.

Cumulative soybean export sales through late December were up 34.9% from a year earlier. Export inspections were up 23.5%. USDA's supply-demand projections call for a 20.9% increase in marketing year total U.S. soybean exports. To meet that projection, soybean export inspections for the rest of the marketing year will need to be 19% higher than a year earlier. In other words, to meet USDA projections, soybean export shipments will need to continue to show a percentage increase over a year earlier that is only slightly less than the rate during the September-December 21, 2006 period. ***With a continuation of current South American crop conditions, it may be a challenge to maintain that rate of increase from March onward, when new-crop South American supplies are readily available.***

November 2007 soybean futures on December 29 finally closed above late November highs, but have shown more restrained strength than corn. So far, the old-crop soybean futures remain below November highs. Upside potential in soybean prices was being tempered by (1) continued reports of very good crop conditions in South America, (2) U.S. August 31, 2006 carryover stocks that are expected to be in the 9 to 10 weeks supply area, (3) competition in meal markets from large distillers grain supplies, and (4) tightening margins for biodiesel processors when soybean oil prices move above \$0.29 to \$0.30 per pound. Further substantial upside potential in soybean prices likely would need deteriorating crop conditions in South America, serious U.S. crop problems next spring, or a larger decline in 2007 U.S. soybean plantings than is currently anticipated. The most critical part of the growing season for South American soybeans is January, February, and early March.

Current vs. Summer-Delivery Prices

Producers who have corn and soybeans stored in farm bins may want to watch bids for May through July delivery. At this writing, bids for soybean delivery in June at some elevators are as much as \$0.33 to \$0.40 per bushel above current cash markets. Bids for corn at some ethanol plants are as much as \$0.23 to \$0.25 per bushel above cash markets. Corn bids for July delivery at some locations reflect an 8 to 11 cent better basis than for current delivery. For soybeans, the basis reflected for summer delivery generally is similar to the current relatively weak basis. With tightening carryover stocks, an even stronger corn basis may occur at times between now and mid-summer.

Indicators to Watch

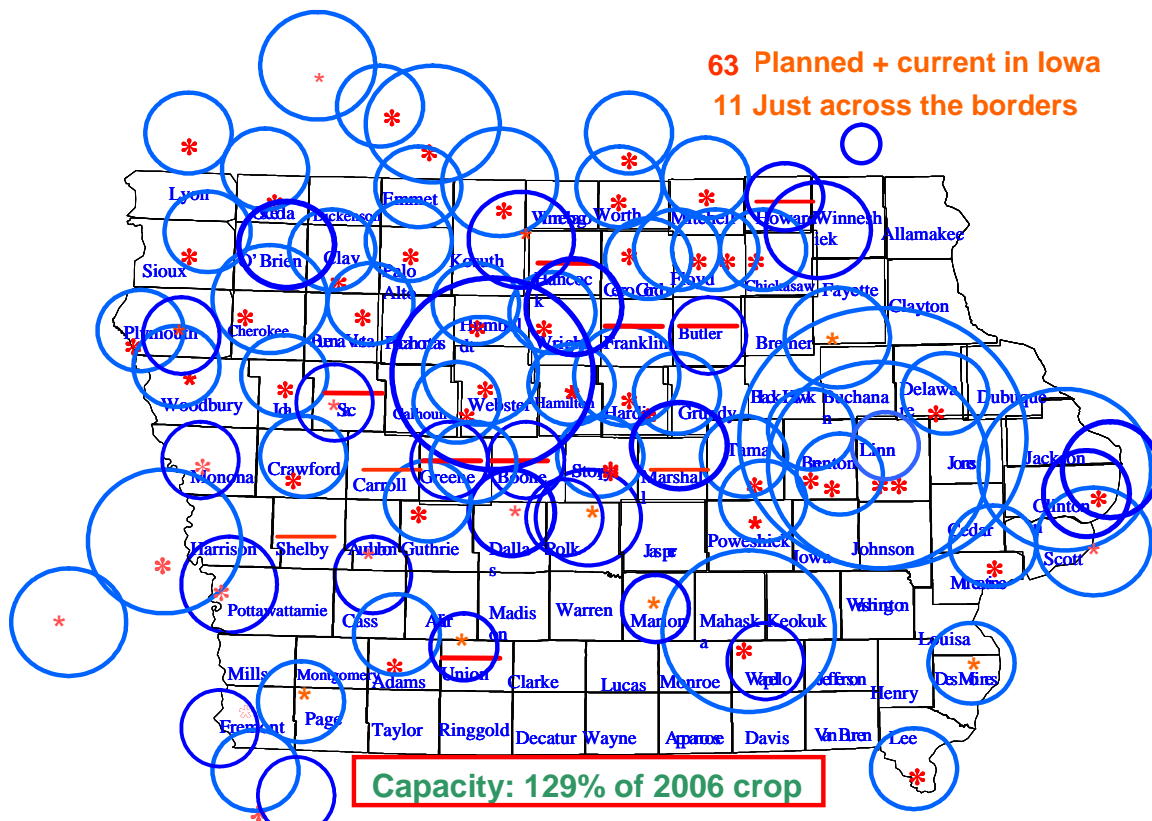
On January 12, USDA will release (1) season final production estimates for 2006-crop corn and soybeans, (2) December 1 grain stocks figures, and (3) its updated U.S. and world grain and soybean supply-demand report. History shows that when the corn crop estimate declines from September to October to November, as it did in 2006, odds are very high that it will decline again in January. For soybeans, the 2006 crop estimates showed increases from September to October to November. History says the odds are high that with this kind of pattern, the 2006 soybean crop estimate may increase again in January. However, that prospect is tempered some by reports of bean yields that were a bit less than anticipated in some areas.

The stocks report will provide an updated indication of corn feeding so far this marketing year. Large hog and cattle-on-feed numbers suggest we should expect fall quarter corn feeding to be above a year earlier. USDA projections show U.S. corn feeding for the marketing year being down 1.4% from a year earlier. Feed use above last season and/or a slight reduction in the 2006 crop estimate could lead to further price strength in January. The world supply-demand report will provide updated indications of South America's crop prospects, Chinese import demand for soybeans, and early indications of potential foreign competition in grain and soybean export markets. At this writing, the indicators suggest South American crop projections may be slightly higher than indicated last month.

Planned and Existing Iowa Corn Processing Plants & the Corn Basis

The map below shows existing corn processing plants (for ethanol and other products), those under construction or expanding, and planned plants as of late December. ***Returns from processing corn for ethanol have increased significantly since late September 2006, despite the rise in corn prices. That's because prices for both ethanol and dry distillers grain (DDGS) have increased.*** A useful rule of thumb is that each dime increase in ethanol prices will increase the maximum price ethanol processors can pay for corn by about \$0.28 per bushel. That is assuming that other influences on ethanol profitability, especially natural gas and DDGS prices, remain unchanged. Since the low in late September, Iowa spot ethanol prices have risen about \$0.85 per gallon. Another rule of thumb, with the same assumptions, is that each one dollar rise in corn prices increases the cost of producing corn-based ethanol by about \$0.36 per gallon.

The circles in the map below show the approximate corn supply areas for the processing plants, with normal corn yields locally and state-wide. In years of reduced crop yields, the size of the circles will increase because plants will have to draw supplies from further away. Growth of the ethanol industry already has dramatically changed basis patterns across Iowa. Further changes are almost certain to occur in the next few years. Historically, river markets in east central and southeastern Iowa have had the highest corn prices in the state. However, at times this fall, prices at some central Iowa processors have exceeded those along the river. At this writing, one central Iowa processor is bidding \$0.15 per bushel more for corn for harvest delivery than elevators a few miles away. Earlier this year, for short periods of time, we have seen processor bids for later delivery as much as \$0.20 per bushel above local elevators. Most ethanol plants have no more than a week to 10 days storage capacity. Plants will bid aggressively for corn when supplies run low because it is expensive and complicated to shut down the plants and restart operations later. As more ethanol plants are built, the basis will become increasingly variable, and in years of short crops, local Iowa cash corn prices could well be higher than Chicago futures. The changing basis environment creates opportunities for farmers with farm storage and semi-trucks. Monitoring daily basis movements at a number of locations will pay large dividends and may also help pay for new bins.



Iowa corn processing & ethanol plants, current & planned, 11/20/06

Robert Wisner

Pork Supplies Expand into 2007

The USDA released its estimate of the December 1, 2006 inventory of hogs and pigs on December 27. The USDA numbers were near trade expectations and are not expected to cause a major market adjustment. USDA indicated that the inventory of hogs was 62.1 million head, up

1.1% from the year before. The number of market hogs increased 1.1% and the breeding herd increased 1.3%. Table 1 summarizes the report for the US and Iowa.

Jun-Aug and Sep-Nov pig crops were up 2.2% and 2.6%, respectively. These are estimates of 1st and 2nd quarter 2007 slaughter. Dec –Feb farrowing intentions also showed a 2.2% increase from year earlier levels suggesting that hog slaughter for the third quarters of 2007 will be at least 2% higher than it was in 2006. The Mar-May intentions are up only 0.5%. This may be revised upward later as the Dec-Feb intentions were identical to the year before in the September report, but are now up 2.2%.

Table 1. Summary of December 2006 USDA Hogs and Pigs Report

	US Million hd	% Chg. 2005	Iowa Million hd	% Chg. 2005
All Hogs	62.15	1.1	17.20	3.6
Breeding Herd	6.09	1.3	1.08	0.9
Market Hogs	56.06	1.1	16.12	3.8
Under 60	20.33	1.4	4.87	5.6
60 - 119	13.60	0.6	4.40	5.3
120 - 179	11.54	2.2	3.62	2.8
180 & over	10.58	0.1	3.23	0.3
Pig Crop				
Jun - Aug	26.73	2.2	4.14	0.0
Sep - Nov	26.55	2.6	4.21	2.8
Sows farrowing				
Dec - Feb	2.90	2.2	0.45	-1.1
Mar - May	2.93	0.5	0.47	2.2

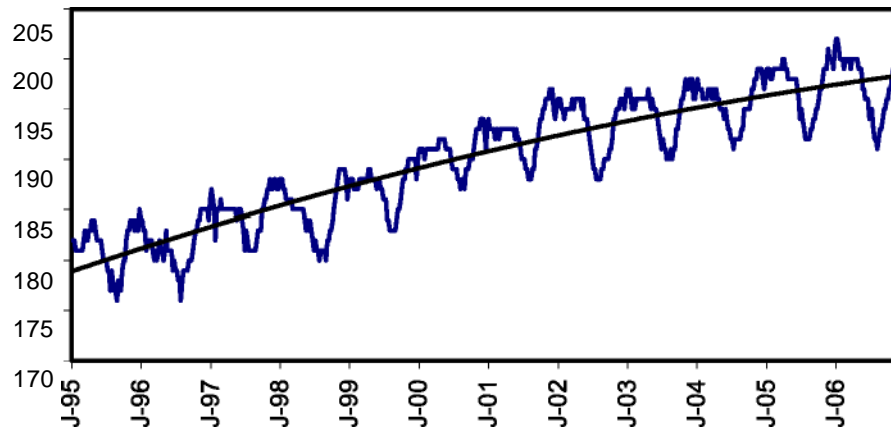
Iowa's hog inventory increased faster than the nation and now stands at over 17 million hogs. The state's breeding herd increased, but at a slower pace, and Iowa farrowings are expected to be lower this winter than a year ago.

Supply Factors

In addition to inventory and farrowing intentions, carcass weights, sow productivity, and Canadian live hog and feeder pig imports add to the US supply. These variables may not be as large of a factor in 2007 as they have been in earlier years.

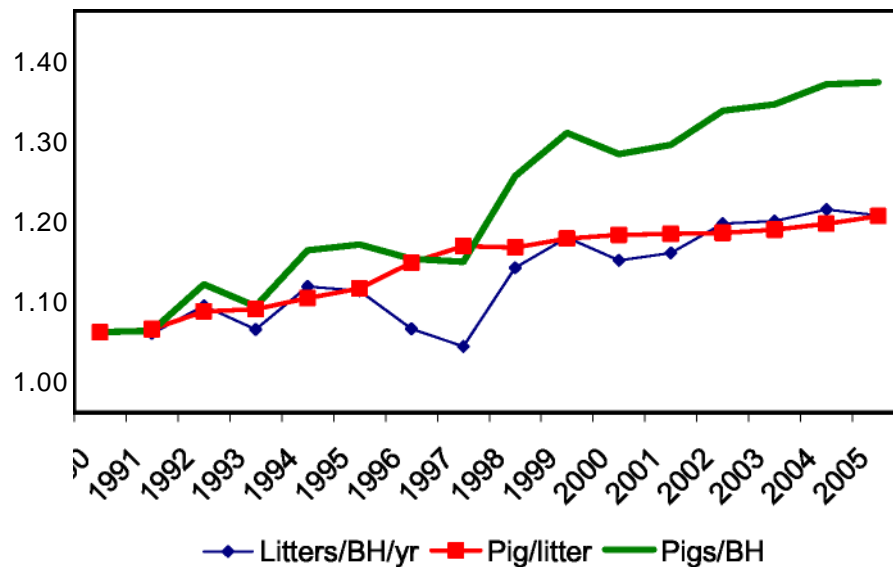
Carcass weights are expected to be steady or lower on a year-over-year basis due to higher feed cost. This adjustment has already begun. Barrow and gilt carcass weights in the second half of 2006 were identical to the same period in 2005. However, the typical pattern is for weights to increase each year (Figure 1), though the rate of increase has slowed.

Figure 1. Weekly Barrow and Gilt Carcass Weights



The other source of productivity is pigs per litter and litters per animal in the breeding herd. Figure 2 shows how breeding herd productivity has increased since 1990. Litters per animal in the breeding herd (breeding herd includes sows, gilts, and boars) have increased over 10% as has pigs per litter. Combined, we now produce 30% more pigs per animal in the breeding herd than we did in 1990. However, the rate of increase has slowed and sow productivity is adding less to the supply than it once did.

Figure 2. Breeding Herd Productivity Index, 1990=1.0



The flow of hogs and pigs from Canada may also slow in 2007. The number of slaughter hog imports declined 2% in 2006, but pig imports were up 12% from the year earlier levels. The Jul-Sep pig crop in Canada was down 3.4% and farrowing intentions for Oct-Dec are down 2.1%, both are year-over-year comparisons. To put this in perspective, the Jul-Sep decrease is the second decrease in Canada in 10 years as their pork industry has grown. The other decrease was Oct-Dec 2005. A stronger Canadian dollar and a moratorium on hog buildings in Manitoba are expected to slow growth of the Canadian herd. As a result we may see fewer slaughter hogs imported to the US for slaughter. There may also be a reduction or at least slower growth in pig imports, but the demand for pigs by US finishers will also be a factor. While some farmers may opt to sell corn

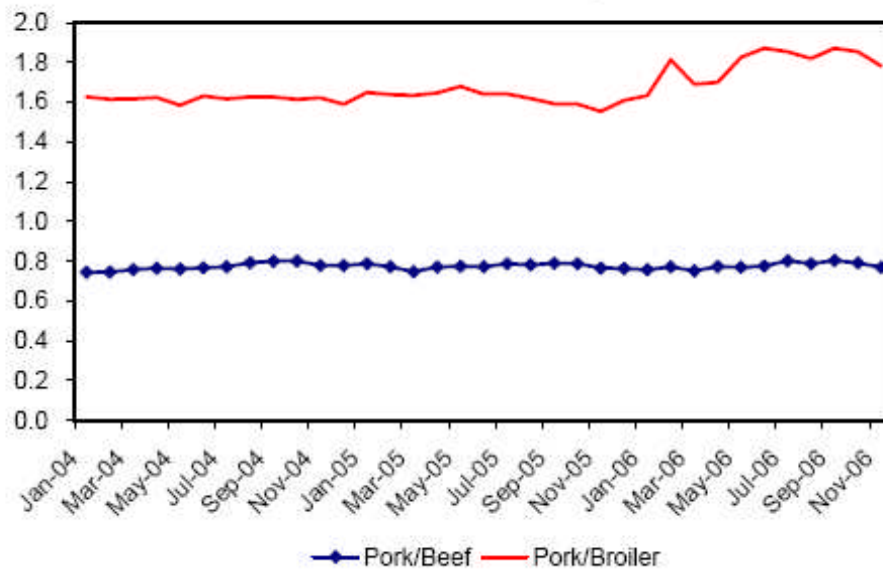
rather than buy pigs to finish, many have a large sunk cost in facilities to consider. If they can cover the variable cost they have an incentive to operate the facilities.

Demand Factors

Domestic pork demand was weaker in 2005 than it was in 2004 and while this year's demand estimates are not finalized, indications are that pork demand has been weaker again in 2006. Much of this weakness in domestic demand has been masked by strong pork export demand. US pork exports Jan-Oct were 11% higher than the year before. This will make 15 of the last 16 years that pork exports have set a new record. Pork exports to Japan, our largest customer, were down 7.4% through October, as were exports to mainland China. Volume to the other major export markets was higher.

Retail pork prices started the year lower than in 2005, but moved higher than the year before in August and have remained higher through at least November. As shown in Figure 3, the price of retail pork relative to retail beef has been steady, but pork has gotten more expensive relative to chicken in recent months. The broiler industry has begun to reduce supplies in response to narrow margins and higher corn costs. The resulting higher chicken prices should be supportive of pork prices.

Figure 3. Retail Meat Price Relationships



Production and Price Forecast

Based on the supply and demand forecast described above, prices are forecast to remain slightly lower than they were in 2006. Table 2 has my forecast for changes in production and Iowa –Southern Minnesota live hog prices by quarter. It also has the basis-adjusted futures forecast of live prices based on futures closes immediately before the report was released.

Table 2. Hog Production and Price Forecast, December 27, 2006, Live Hog Prices

	ISU Forecast		Futures 12/27/06
	Production	Price	
JAN-MAR	2.0	\$42-45	\$44.91
APR-JUN	2.0	47-50	50.92
JUL-SEP	2.0	47-50	50.38
OCT-DEC	1.5	45-48	46.04

The rising corn prices since Labor Day are beginning to impact cost of production. While feed costs for producing a hog start prior to conception, the majority of the feed is consumed in the last three months before slaughter. We are in the process of updating the Estimated Returns to Livestock Feeding Series and will have revised values and procedures beginning with January 2007. The revised numbers suggest that it takes approximately 12 bushels of corn to produce a hog farrow-to-finish and the new weight is 270 pounds. Thus, a \$1/bushel increase in corn prices will result in a \$4.44/cwt (live) increase in cost of producing hogs or about \$6/cwt carcass weight.

Given the now higher corn prices and price forecast, pork producers may see some red ink during the first quarter of 2007. Summer prices should be higher than cost of production unless corn and/or soybean meal prices increase further. If we have sustained corn prices in the mid-\$3.00/bu range producers are expected to be in the red again in the 4th quarter.

John Lawrence